IN THE

Supreme Court of the United States

October Term, 1948

No. 501

FREDERICK JOHN WOLFE,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

REPLY BRIEF

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In his brief respondent (1) argues the merits of the case, and (2) argues that the decision in the instant case is not in conflict with decisions of United States Courts of Appeals other than the United States Court of Appeals for the Ninth Circuit.

As to respondent's argument on the merits.

The burden of the respondent's argument is that the resolution adopted by the Anglo directors on October 22, 1931 established the right of the petitioner to receive a pension from Anglo, that Anglo would have paid such pension

in sterling if the petitioner had continued to live in England and that the agreement of March 22, 1940 was the result of petitioner's wish to live in the United States after his retirement and to be paid in United States dollars. These facts are true, but do not lead to the conclusion which respondent suggests.

It is conceded that a promise by an employer to pay a pension to an employee does not result in income to the employee at that time, and that if, as, and when payments are made in accordance with such promise, the entire amount thereof constitutes income to the employee. It has been uniformly held, however, as evidenced by the cases referred to in petitioner's main brief, that where the employer instead of merely giving its own promise purchases the promise of a third party to make such payments, the amount paid by the employer for the third party's promise constitutes income to the employee at the time of such payment, and that the amounts thereafter paid to the employee by such third party are taxable to the employee in accordance with the provisions of section 22 (b)(2) of the Internal Revenue Code.

If the contract of March 22, 1940 had not been made, there would be no dispute; we would concede that any payments made by Anglo to the petitioner constituted income to him in full. However, the contract of March 22, 1940 *was* entered into. Under that contract, Anglo paid immediately the sum of approximately $415,000, the full actuarially computed value of its obligation to pay a pension. Anglo thus discharged in full, by an immediate payment, the liability which it otherwise would have had to pay a pension to the petitioner over a period of years in the future, a payment very much more than Anglo would have been required to pay if the contract had not been made and if the petitioner had died shortly after his retirement. The payment

by Anglo of approximately $415,000 was at the request of, and for the specific purpose of benefiting, its employee, the petitioner.

The argument of the respondent that since the petitioner already had an agreement under which he would receive a pension, the payment at his request of about $415,000 to purchase the promise of Standard to pay an equivalent amount to the petitioner in dollars could not constitute income to the petitioner is directly contrary and in conflict with the position urged by the respondent and accepted by the majority of The Tax Court of the United States in *Freeman* v. *Commissioner of Internal Revenue* (4 T. C. 582, on appeal C. A. 2). In the *Freeman* case, Freeman's employer (an individual) entered into an agreement whereby he agreed to pay Freeman $12,000 a year for the rest of his life, and if Mrs. Freeman survived to pay her $8,000 a year until her death, the agreement specifically referring to payments by the employer "(or my estate)". After the employer's death, the estate obtained a release from Freeman by the payment of about $8,600 in cash (the amount then due under the original agreement) and the payment of about $71,000 to an insurance company to purchase an annuity under which Freeman would receive about $6,000 a year. The respondent contended, and the majority of the Tax Court held, that the sum of $71,000 paid to the insurance company represented income to Freeman, despite the fact that he would receive, under the insurance contract, an annual amount considerably less than he would have received under the original agreement. Certainly, if an employee receives income upon the substitution of a third party's promise to pay him $6,000 a year for his employer's promise to pay him from $8,000 to $12,000 a year, an employee must be considered as having received income when his employer buys the promise of a third party to pay to the

employee an amount greater than the employer was previously obligated to pay.

The respondent relies heavily upon *Hooker* v. *Hoey* (27 F. Supp. 489 (S. D. N. Y.) affirmed *per curiam*, 107 F. (2d) 1016 (C. A. 2)). We have no quarrel with that decision and believe it was correctly decided. However, it has no bearing upon the issue here presented. In that case, the taxpayer was receiving a pension from the Vacuum Oil Company. In 1931, the Vacuum Oil Company sold all of its property to Standard Oil Company of New York, the latter company assuming all obligations and liabilities of the Vacuum Company, including the obligation of the Vacuum Company to pay a pension to the petitioner. The taxpayer contended that the amounts thereafter received from Standard Oil Company of New York were annuity payments. In rejecting that argument, the District Court assigned three reasons as follows:

> (1) There was no purchase of an annuity.
>
> (2) There was no annuity contract.
>
> (3) ". . . there is utterly no basis in the facts for the claim that the sum of $79,186.46 or any other particular sum was paid by Vacuum Oil Company to Socony Vacuum Corporation as 'aggregate premiums or consideration' for the latter's assumption of the obligation to pay the plaintiff $11,250 a year for life."

In the instant case, Anglo did, for the sum of $415,000, purchase a contract under which the taxpayer was to receive annual payments during his lifetime; there can be no dispute that the $415,000 was paid for that purpose and none other (R. p. 24). Consequently, none of the reasons assigned by the Court for its decision in the *Hooker* case is applicable here. The distinction between the *Hooker* case on the one hand and *Hackett* v. *Commissioner of In-*

ternal Revenue (159 F. (2d) 121) and the instant case on the other is obvious; in the *Hooker* case, the sale by the employer of its assets subject to its liabilities did not result in the employee receiving "an economic benefit conferred as additional compensation which is the equivalent of cash".[1] In the *Hooker* case, no contract was issued to the employee nor was there any basis for a contention that the transaction conferred any economic benefit on the employee as additional compensation. The purpose of the transaction was not to assure the payments to the employee, nor did Vacuum pay any particular amount to Socony in consideration of an agreement by the latter to make payments to the employee. In the instant case, there was a payment of a specific amount in cash ($415,786.75). It was specifically paid to purchase a contract under which the petitioner would receive an annuity for his lifetime. It was paid at the request of the petitioner and for the purpose of conferring a benefit upon him.

We wish to call to the Court's attention that the facts contained in the paragraph beginning at the bottom of page 5 of the respondent's brief regarding the proposal that the annuity be paid in New York in dollars and that Anglo transfer funds to Standard are based upon statements made by Mr. F. W. Pierce in a letter dated June 29, 1939 which, as pointed out on page 29 of our main brief, was written before any decision was made as to how the transaction was to be handled and by a gentleman who on January 12, 1940, more than six months later, wrote that on January 9, 1940 he "failed to realize" what the arrangement then was (R. p. 85). The agreement of March 22, 1940 constituted no mere deposit arrangement. Anglo had no further interest in the $415,000 whether the petitioner lived more or less than his life expectancy. Standard had received $415,000 which

[1] *Hackett* v. *Com'r* (159 F. (2d) 121, 123).

it was to keep whether the amounts paid to the petitioner proved to be very much more or less than that amount.

Respondent rests his argument in part on the erroneous finding of The Tax Court of The United States that Standard Oil Company of New Jersey in 1931 guaranteed the payment of petitioner's pension at $5.00 to the pound. This and related findings were assigned as error (R. p. 46), and were argued in the Court below. Rather than encumber this brief with a detailed discussion of evidence we append hereto excerpts from petitioner's brief in the Court below. No attempt was made by the respondent to answer these arguments in the Court below. It is, however, immaterial whether Standard did or did not guarantee the payments. Even if Standard did make a guarantee, it was unenforcible since not in writing (Section 31, New York Personal Property Law). Further, Anglo, the petitioner's employer, did in fact pay a consideration for Standard's agreement to pay the annuity pursuant to the contract of March 22, 1940, to wit, $415,786.75.

As to respondent's argument that there is no conflict in the decisions.

Respondent contends (p. 12 of his brief) that the decision in the instant case is not in conflict with *Hackett* v. *Commissioner of Internal Revenue* (159 F. (2d) 121), *Ward* v. *Commissioner of Internal Revenue* (159 F. (2d) 502), *Hubbell* v. *Commissioner of Internal Revenue* (150 F. (2d) 516), and *Oberwinder* v. *Commissioner of Internal Revenue* (147 F. (2d) 255) because in the cited cases—

(1) The employer purchased an annuity contract from an insurance company.

(2) The employee was still in service.

(3) The purchase price of the annuity contract was compensation to the employee.

(4) The employer did not set up a well defined pension plan.

(5) It was not argued that the installment payments were not annuities.

We will briefly dispose of these contentions.

(1) As to the fact that the annuity contract was written by Standard Oil Company of New Jersey and not by an insurance company, see paragraph 2 on page 11 of the Petition for Writ of Certiorari and pages 17, 18 and 19 of our main brief.

(2) As to the fact that in the cited cases the employee was still in service: The petitioner was also still in service. In the cited cases, as in the instant case, the annuity was in the nature of a pension.

(3) As to whether the purchase price of the annuity contract in the instant case was compensation to the petitioner, see pages 16 to 19, both inclusive, of our main brief. Respondent asserts without giving any reasons that "it could not reasonably be said that he (petitioner) received a bonus of $415,000, when his salary was £11,000 ($55,000) (R. 23, 67), and he worked only six months in the year of his retirement (R. 26)". Why not? In any event had the transaction occurred in the United States, it would have been held under the rationale of the cited cases, that the $415,000 was compensation to the petitioner.

(4) As to the fact that the employers in the cited cases did not set up "a well defined pension plan" the fact remains that in the cited cases the annuities were in the nature of pensions. Further, Anglo's pension plan was not one "with respect to which the employer's contribution was deductible under section 23 (p)(1)(B)" nor was Anglo

"exempt under section 101 (6)". See section 22 (b)(2)(B) of the Internal Revenue Code quoted on page 21 of our main brief. Consequently, the "amount contributed by the employer (Anglo) * * * shall be included in the income of the employee (the petitioner) * * * and shall constitute the consideration paid for the annuity contract * * *". Therefore, whether Anglo did or did not have a "well defined pension plan" is immaterial.

(5) As to the alleged fact that in the cited cases it was not argued that the installment payments were not annuities, the argument now made by the respondent was, however, made in the cited cases, namely that the annuities were pensions.

On page 13 of his brief, respondent argues that the decision in the instant case is not in conflict with *Ware* v. *Commissioner of Internal Revenue* (159 F. (2d) 542), *Beattie* v. *Commissioner of Internal Revenue* (159 F. (2d) 788), *Raymond* v. *Commissioner of Internal Revenue* (114 F. (2d) 140), and *Gillespie* v. *Commissioner of Internal Revenue* (128 F. (2d) 140) because the annuities in the cited cases were not in the nature of pensions. But it was contended in the cited cases that the annuities were not annuities (precisely the contention the respondent makes here) and the argument was rejected. The cases are in conflict in that in the instant case a similar argument was sustained.

Conclusion.

It is respectfully submitted that the petition for writ of certiorari should be granted as prayed for.

Respectfully submitted,

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APPENDIX.

2. *The Tax Court of The United States erred in failing to find as a fact that petitioner did not, prior to March 1, 1931, discuss with any official of Standard or Export the question of his retirement pay in the event of his eventual retirement, and that the question of petitioner's retirement pay in the event of his eventual retirement was never, prior to March 1, 1931, mentioned in the conversations between petitioner and officials of Standard and Export in any way, shape or form.*

Statement of wherein the findings of fact are, with respect to this the Second Specification of Error, erroneous.—On direct examination, petitioner testified: That prior to March 1, 1931, two or three months prior to that, Mr. G. Harrison Smith, who was the senior vice-president of Imperial, asked the petitioner if he (petitioner) would go to England to take over the duties as managing director of Anglo; that he (petitioner) had conversations with executives of Standard with respect to the matter of petitioner's going to England to take over this new position; that he (petitioner) talked with several of the executives; that he (petitioner) talked to Mr. Teagle, who was then president of Standard, to Mr. Hunt, who was one of the vice-presidents, to Mr. James Moffett, who was one of the vice-presidents, and to Mr. D. L. Harper, who was president of Export; that he (petitioner) talked to these gentlemen in Standard largely to get the background of Anglo (R. p. 60); that *he (petitioner) did not at any time discuss with Mr. Smith, Mr. Teagle, Mr. Hunt, or any of the other gentlemen whose names he had mentioned, the question of his (the petitioner's) retirement pay in the event of his eventual retirement; that the question of petitioner's retirement pay was never mentioned,—in any way, shape or form* (R. p. 61).

With respect to the first paragraph of the agreement of March 22, 1940, which provides that petitioner undertook the assignment as chairman and managing director of Anglo on March 1, 1931, on the understanding that if he were eventually retired from the service of Anglo he would receive a life annuity based on the provisions of the superannuation scheme of Anglo and that payment would be guaranteed by Standard (R. pp. 23-24), petitioner testified that there was no understanding with any officer of Standard or Imperial; that the understanding stated in that paragraph was petitioner's understanding; *that he had not discussed the matter with any official of Standard or Imperial* (R. p. 61).

On cross examination, petitioner testified that he (*petitioner*) *had no understanding as to his retirement pay at the time he entered the employ of Anglo* (R. p. 73).

No evidence contradictory to the foregoing was offered at the trial; therefore there is no issue as to truth of the fact which The Tax Court of The United States failed to find.

It was error not to find such fact. The respondent's entire theory in this case is that Standard was not the writer of an annuity, that, on the other hand, Standard was, in entering into the contract of March 22, 1940, satisfying an obligation of Standard to petitioner. The fact that petitioner did not even discuss with any officer of Standard the question of his retirement pay is certainly pertinent to the issue of whether Standard had an obligation to petitioner with respect to that retirement pay.

3. *The Tax Court of The United States erred in failing to find as a fact that the facts stated in the paragraph beginning "Whereas" of the contract between petitioner, Anglo and Standard, set forth in the eleventh paragraph*

of the findings of fact (R. pp. 23-24), *are true except that there was no understanding with any officer of Standard or of Imperial that if petitioner were eventually retired from the service of Anglo he would receive a life annuity based on the provisions of the superannuation scheme of Anglo as in effect on the date of retirement, and that payment of such sterling pension would be guaranteed by Standard at an exchange rate of five dollars to the pound.*

Statement of wherein the findings of fact are, with respect to this the Third Specification of Error, erroneous.— The undisputed evidence as to the truth of the facts stated in the paragraph beginning "Whereas" of the contract between petitioner, Anglo, and Standard (R. pp. 23-24) with respect to the alleged understanding with officers of Standard and Imperial that if petitioner were eventually retired from the service of Anglo he would receive a life annuity, etc. is set forth under specification of error 2. That evidence is all to the effect that there was no such understanding.

With respect to the alleged understanding prior to March 1, 1931, with officers of Standard that payment of such sterling pension would be guaranteed by Standard at an exchange rate of five dollars to the pound, the undisputed evidence is:

On direct examination the petitioner testified that he (petitioner) had always been a citizen of Canada (R. p. 59). As The Tax Court has correctly found as facts petitioner resided in Canada until 1931 and in England from 1931 to October 4, 1941 (R. p. 16). On cross examination petitioner testified that when he went to England in 1931 Standard did not guarantee the payment of a retirement to him (R. pp. 73-74). On direct examination, petitioner testified that:

he was a real sufferer from asthma and had been advised by his physician that when the opportune time came he should get out of England and go to a warmer country, such as California (R. p. 66); that prior to August 1939 he decided to retire (R. p. 65); that *after making the decision to retire,* he had conversations with an executive of Anglo in which he (petitioner) stated that he intended to live in the United States and that he would want his annuity payable to him in American dollars (R. p. 66), and that thereafter petitioner discussed the matter with an executive of Standard, in which discussion the executive of Standard particularly asked petitioner what the rate of exchange was that petitioner wanted (R. p. 67). On *June 16, 1939,* the same officer of Standard with whom petitioner had had said discussion wrote him (petitioner) that the problem of paying the annuity in dollars had been left for *future* consideration (R. pp. 87-88). A memorandum accompanying said letter of *June 16, 1939,* gave the amount of annuity due petitioner, assuming his retirement on various dates, *in pounds not in dollars* (R. p. 89). In a memorandum dated *June 21, 1939,* prepared by an employee of Standard, the annuity due petitioner, assuming retirement on various dates, was shown in dollars, *converted at $4.68 to the pound,* not at $5.00 to the pound (R. p. 92). In a memorandum from one executive of Standard to another dated *June 29, 1939,* it was stated as an understanding that petitioner was to receive a life annuity payable in the United States in dollars converted at the rate of $5.00 to the pound (R. p. 20) and that *subject to proper approval* it was proposed that the annuity be paid in New York in dollars, converted at the rate of $5.00 to the pound (R. pp. 20-21, 81-83).

From the foregoing undisputed evidence it is obvious that petitioner did not on *March 1, 1931,* undertake the as-

signment as chairman and managing director of Anglo on an understanding with officers of Standard that if he were eventually retired from the service of Anglo he would receive a life annuity based on the provisions of the superannuation scheme of Anglo as in effect on the date of retirement, and that payment of such sterling pension would be guaranteed by Standard in dollars at an exchange rate of five dollars to the pound.

It was error to fail to so find as a fact. The respondent's case depends in large part on the premise that Standard assumed an obligation to petitioner prior to March 1, 1931. That Standard assumed no such obligation is certainly pertinent.

4. *The Tax Court of The United States erred in finding as a fact that when the petitioner undertook the assignment of chairman and managing director of Anglo at the request of Standard it was the understanding that if he were eventually retired from the service of Anglo he would receive a life annuity based on the provisions of the superannuation scheme of Anglo in effect on the date of retirement, and that payment of such sterling pension would be guaranteed by Standard in dollars at an exchange rate of five dollars to the pound.*

Statement of wherein the findings of fact are, with respect to this the Fourth Specification of Error, erroneous.— The undisputed evidence with respect to this specification of error is set forth under specification of error 2 and specification of error 3. Every bit of that evidence negatives, rather than affirms, the finding of The Tax Court of The United States. For example, disregarding for the moment the direct denials of the petitioner, why should a citizen of Canada, who had always been a resident of

Canada, and who was taking a position in England, demand that an annuity to be paid to him on his eventual retirement from that position in England, be paid in American dollars? Or why, under such circumstances, should anyone guarantee the payment of such an annuity in dollars? It is quite apparent that the idea of paying the annuity in dollars arose from the advice of petitioner's physician that, because of his asthma, he go to a climate such as California (R. p. 66) and that there was *no* discussion of payment of the annuity in dollars until *1939*, when petitioner decided to retire and live in the United States (R. pp. 65-66). If Standard *in 1931* had had an understanding that petitioner on retirement was to receive his annuity in dollars converted at $5.00 to the pound, why did an officer of Standard *in 1939* ask what rate of exchange petitioner would expect? If Standard *in 1931* had an understanding that petitioner on retirement was to receive his annuity in dollars, why did an officer of Standard *on June 16, 1939*, write that the problem of paying the annuity in dollars had been left for *future* consideration? If Standard *in 1931* had an understanding that petitioner on retirement was to receive his annuity in dollars converted at $5.00 to the pound, why did Standard compute the annuity *on June 16, 1939, in pounds*, not in dollars? And why did Standard *on June 21, 1939*, compute the annuity at a rate other than $5.00 to the pound? If *in 1931* Standard had an understanding that petitioner, on retirement, was to be paid his annuity in dollars converted at $5.00 to the pound, why was it that *on June 29, 1939*, the proposal that the annuity be paid in New York in dollars, converted at the rate of $5.00 to the pound, was "subject to proper approval"?

. . . . . .

8. *The Tax Court of The United States erred in failing to find as a fact that the petitioner wanted an annuity payable in dollars because he had been advised by his physician on many occasions that England was not a proper climate for him and he intended to go to the United States upon his retirement.*

Statement of wherein the findings of fact are, with respect to this the Eighth Specification of Error, erroneous.— On direct examination the petitioner testified: That prior to August 1939, he decided to retire from his position with Anglo; that he had been advised by his physician on many occasions that England was not a proper climate for petitioner; that petitioner was a real sufferer from asthma and had been advised by his physician that when the opportune time came, petitioner should get out of England and go to a warmer climate, such as California (R. p. 66); that after making the decision to retire, petitioner had conversations with Mr. Carder, who was on the board of directors and was financial director of Anglo; that petitioner told Mr. Carder that he (petitioner) intended to live in the United States; that petitioner told Mr. Carder further that when he retired (and he was planning on retiring) petitioner would want his annuity payable to him in American dollars (R. p. 66).

This evidence was undisputed. There is therefore no issue as to the facts in question.

It was error to fail to so hold. The facts in question are pertinent in that they show why the annuity was payable in dollars and in that they negative the fact, erroneously found by The Tax Court of The United States, that payment of the annuity in dollars had been guaranteed by Standard in 1931.

9. *The Tax Court of The United States erred in failing to find as a fact that in 1939 the financial director of Anglo suggested that the problem of the petitioner's annuity might be worked out by Anglo sending over a certain amount of money to Standard and that the latter would pay the annuity.*

Statement of wherein the findings of fact are, with respect to this the Ninth Specification of Error, erroneous.— On direct examination petitioner testified: That prior to August 1939, he decided to retire from his position with Anglo (R. p. 65); that after making the decision to retire, he had conversations with Mr. Carder who was on the board of directors and financial director of Anglo; that he told Mr. Carder that he (petitioner) intended to live in the United States; that he told Mr. Carder further that when he (petitioner) retired (and he was planning on retiring) he would want his annuity payable to him in American dollars; that he and Mr. Carder discussed the matter of his purchasing an annuity from an insurance company; and that then Mr. Carder suggested that it might be worked out by Anglo sending over a certain amount of money to Standard and the latter would pay the annuity (R. p. 66).

There is no evidence to the contrary. Hence there is no issue as to the facts in question.

It was error to fail to so find. The facts in question are material as showing how it happened that Standard paid the annuity to petitioner and as negativing the erroneous inference of The Tax Court of The United States that Standard in paying the annuity was satisfying an obligation incurred by it in 1931.

• • • • • • •

11. *The Tax Court of The United States erred in failing to find as a fact that the petitioner was never in the employ of Standard or Export.*

Statement of wherein the findings of fact are, with respect to this the Eleventh Specification of Error, erroneous.—On direct examination the petitioner testified: That he was never in the employ of Standard; that he was never in the employ of Export (R. p. 68). Kenneth N. Rackley, called as a witness on behalf of the respondent, who was, at the time of the trial, secretary of the annuities and benefits committee of Standard (R. p. 77), testified, on cross examination, that to his knowledge petitioner had never been an employee of Standard; and that when he spoke on direct examination (R. p. 86) of the official file of Standard relating to the retirement of petitioner (R. p. 80) as the employee's file, it was not his intention to characterize petitioner as an employee of Standard (R. p. 86).

There is no evidence to the contrary. There is no issue therefore as to the truth of the facts in question.

It was error to fail to so find. The fact that petitioner was never an employee of either Standard or of Export goes to the heart of this controversy. Standard could not, under such circumstances, have had an obligation to him as an employee.